

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:)	Bankr. No. 03-10042
)	Chapter 7
KERMIT R. JOHNSON)	
f/d/b/a New Kitchen)	
f/d/b/a FB&I Building Products)	DECISION RE: MOTION
Soc. Sec. No. 504-56-3998)	TO COMPEL ABANDONMENT
)	
Debtor.)	

The matter before the Court is the Motion to Compel Abandonment filed by First Premier Bank and the response thereto filed by Debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and accompanying Order shall constitute the Court's findings and conclusions under Fed.R.Bankr.P. 7052 and 9014. As set forth below, the Bank's Motion will be denied.

I.

Kermit R. Johnson ("Debtor") filed a Chapter 7 petition in bankruptcy on February 4, 2003. Among his assets, Debtor scheduled a half interest in some real property in Codington County, South Dakota.¹ Debtor valued his interest in this property at \$33,172.50, and he stated that First Premier Bank ("Bank") had a fully secured claim against it for \$18,500.00. Debtor claimed the equity in the Codington County property

¹ The record is unclear on who owned the other half interest on the petition date.

exempt as his homestead to the extent of \$14,672.50. No one timely objected to this claimed exemption.

The Bank filed a motion to compel the case trustee to abandon the bankruptcy estate's interest in the Codington County property.² Debtor objected to the Bank's motion. He argued that he was current on the only note that was secured by the Codington County property, contrary to the Bank's claim that this real property severed as collateral for two different notes.

According to stipulated facts submitted by Debtor and the Bank, Debtor and his wife, Mary Beth Johnson,³ borrowed \$40,000 from the Bank on March 12, 1999, to purchase the Codington County realty, a single family residence that became a rental property. They gave the Bank a "Collateral Real Estate Mortgage" on the house to secure the note, which was recorded on March 16, 1999. The mortgage limited the mortgage lien to

² The Bank also sought relief from stay on some personalty. No party in interest objection to that relief and a separate order regarding it was entered.

³ The parties' stipulated facts actually state that only Mary Beth Johnson executed the March 12, 1999, note and mortgage. Both Debtor and Mary Beth Johnson signed the documents, however. Counsel for both parties confirmed that fact with the Court subsequent to the filing of their stipulated facts.

\$40,000.

On October 26, 1999, Debtor and his wife borrowed \$115,000 from the Bank to purchase a family home. Both signed the promissory note and they gave the Bank a first mortgage on the house to secure the debt. On October 26, 1999, Debtor and his wife also gave a second "Collateral Real Estate Mortgage" on the Codington County property as additional security for the \$115,000 note. This mortgage was recorded on October 28, 1999.

Debtor and Mary Beth Johnson divorced in January 2001. She wanted to be released from liability on the March 12, 1999, note. To accomplish that, Debtor and his brother, Dennis Johnson, borrowed \$40,616.93 from the Bank on December 28, 2001. This note was secured by another "Collateral Real Estate Mortgage" on the Codington County property. Debtor signed the mortgage on December 28, 2001, his brother signed it on January 8, 2002, and the mortgage was recorded on February 8, 2002. Based on this refinancing, the Bank released Mary Beth Johnson from liability on the March 12, 1999, note.

Debtor, who had been awarded the family residence in the divorce, became delinquent on the October 26, 1999, note payments. Since the sale of this home would result in a deficiency, Debtor, with the Bank's approval, sold the family

-4-

residence in March 2002, signed another note to the Bank on June 12, 2002, for the \$20,392.34 deficiency, and gave the Bank a security interest in a mobile home that he received in partial exchange for the home from the purchaser. The face of the note provided, under the paragraph labeled COLLATERAL:

I [Debtor] acknowledge this Note is secured by the following collateral described in the security instruments listed herein, all the terms and conditions of which are hereby incorporated and made a part of this Note:

(A) a Mortgage dated March 12, 1999, to Lender on real property located in CODINGTON County, State of South Dakota.

(B) a mobile home described in a Consumer Security Agreement dated June 12, 2002.

On June 12, 2003, Debtor signed a "Consumer Security Agreement" that gave the Bank a security interest in only the mobile home. The March 12, 1999, mortgage was never amended to provide that it also secured the June 12, 2002, note. The mortgage continued to provide that it secured a sum not to exceed \$40,000 as evidenced by the March 12, 1999, note. Based on the present record, the June 12, 2002, note was never recorded by the Codington County Register of Deeds.

The June 12, 2002, note is not current. Debtor has not made any payments on it since September 12, 2002. On June 26, 2003, the balance due on the June 12, 2002, note was \$24,577.55,

excluding collection costs.

On June 26, 2003, the balance on the December 28, 2001, note was \$40,219.05. Dennis Johnson has kept this note current.

As noted above, Debtor claimed the Codington County property exempt as his homestead. Debtor, however, presently resides in Colorado with his former wife. Debtor's mother lives in the Codington County house and pays rent. The record is unclear regarding who lived in the Codington County house on the petition date. Regardless, the Bank argues that Debtor has waived the right to assert a homestead exemption against the Codington County realty. According to Debtor and the Bank, the Codington County rental house is presently worth about \$80,000.

Based on these facts, Debtor and the Bank presented the following issue to the Court by stipulation: Whether the reference in the June 12, 2002, note, which was delivered by Debtor to the Bank and which incorporated the March 12, 1999, mortgage, is sufficient to secure the June 12, 2002, note with the Codington County property described in the mortgage?

II.

Property may be abandoned from the bankruptcy estate in one of three ways: upon notice by the case trustee, 11 U.S.C. § 554(a), upon motion by a party in interest and order,

11 U.S.C. § 554(b), or upon closing. 11 U.S.C. § 554(c). Property may be abandoned only if it is (1) burdensome to the bankruptcy estate or (2) of inconsequential value to the bankruptcy estate. 11 U.S.C. § 554(a). The proponent of the abandonment has the burden of proof. *Alexander v. Jensen (In re Alexander)*, 289 B.R. 711, 715 (B.A.P. 8th Cir. 2003). To meet this burden, the proponent should ascertain the property's fair market value and the amount and validity of any outstanding liens against it. *New Jersey Department of Environmental Protection v. National Smelting of New Jersey, Inc. (In re National Smelting of New Jersey, Inc.)*, 49 B.R. 1012, 1014 (D. Colo. 1985) (cited in *McGahren v. First Citizens Bank & Trust Co., et al. (In re Weiss)*, 111 F.3d 1159, 1167 (4th Cir. 1997), and *In re Roger L. Dice*, Bankr. No. 96-30095, slip op. at 4 (Bankr. D.S.D. April 2, 1997)).

The only non-Code exception to § 554 is set forth in *Midlantic National Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 507, 106 S.Ct. 755, 762 (1986). There, the Supreme Court held that a case trustee cannot abandon property if the public health and safety would be compromised by the abandonment and there is a showing of "imminent and

identifiable harm" to the public. *Id.* at 507 n.9, 106 S.Ct. at 762 n.9.

III.

The issue raised by the parties is not fully reached in this adversary proceeding. Instead, the Court will limit its ruling to whether the Codington County realty should be abandoned from the bankruptcy estate. Based on the current record, the Court concludes that the case trustee will not be compelled to abandon this property.

Since no party in interest timely objected to Debtor's claimed homestead exemption in the Codington County real property, the property claimed exempt is no longer part of the bankruptcy estate. 11 U.S.C. § 522(b); *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). Debtor, however, declared a homestead exemption only to the extent of \$14,672.50. That means the bankruptcy estate retains any equity in the Codington County property above \$14,672.50. *Soost v. NAH, Inc. (In re Soost)*, 262 B.R. 68, 72-74 (B.A.P. 8th Cir. 2001) (a claimed exemption of \$1.00 in some real estate exempted only \$1.00 in value, nothing more); see *Stoebner v. Wick (In re Wick)*, 276 F.3d 412, 415-16 (8th Cir. 2002) (listing "unknown" as the value

of a claimed exemption is insufficient as a matter of law to make the asset fully exempt).

The Bank and Debtor valued the Codington County property at \$80,000. The Bank's December 28, 2001, mortgage is against the whole property, not just Debtor's interest. With an \$80,000 property value and a present undisputed mortgage claim of \$40,219.05, the equity in the house is \$39,780.95. One-half of this equity, or \$19,890.48, became property of the bankruptcy estate. Debtor declared a homestead exemption of \$14,672.50 in this equity. Assuming there is only one mortgage lien against the property, the remaining equity for the bankruptcy estate is \$5,217.98. Thus, whether there is any equity in the Codington County realty for the bankruptcy estate turns on whether the Bank has a second mortgage on the Codington County realty that is enforceable against the bankruptcy estate. The present record indicates that the Bank does not hold such a mortgage.

As defined by S.D.C.L. § 44-8-26, a "collateral real estate mortgage" represents a continuing lien against certain real property for an amount that may vary over the term of the underlying note but which may never exceed a stated face amount. *See, generally, Farm Credit Services v. Roth (In re Roth)*, 171 B.R. 357, 358 n.1 (Bankr. D.S.D. 1994) (Ecker, J.). Clearly, the

Bank's March 12, 1999, mortgage met the several requirements of § 44-8-26. However, the mortgage, by its own terms did not give notice that the June 12, 2002, note could be secured by this continuing mortgage lien.

The March 12, 1999, mortgage provided that it was "GIVEN TO SECURE (1) PAYMENT OF THE INDEBTEDNESS AND (2) PERFORMANCE OF ALL OBLIGATIONS OF [DEBTOR] UNDER THE MORTGAGE AND RELATED DOCUMENTS." The mortgage defined "Indebtedness" as

all principal and interest payable under the Note and any amounts expended or advanced by [Bank] to discharge obligations of [Debtor] or expenses incurred by [Bank] to enforce obligations of [Debtor] under this Mortgage, together with interest on such amounts as provided in this Mortgage. **The lien of this Mortgage shall not exceed at any one time \$40,000.00.**

[Emphasis in the original.] The mortgage defined "Note" as

the promissory note or credit agreement dated March 12, 1999, **in the original principal amount of \$40,000** from [Debtor] to [Bank], together with all renewals of, extensions of, modifications of, refinancings of, consolidations of, and substitutions for the promissory note or agreement.

[Emphasis in the original.] The June 12, 2002, note that Debtor gave the Bank, however, was not a renewal, extension, modification, refinancing, consolidation, or substitution for the March 12, 1999, note. Instead, Debtor gave the Bank the June 12, 2002, note to cover the deficiency on the October 26,

1999, note and mortgage. Thus, the already-filed March 12, 1999, mortgage did not give notice to third parties that it was securing the June 12, 2002, note. This is especially apparent where the December 28, 2001, note already had become a substitution for the March 12, 1999, note and where a new, separate mortgage was given to secure the December 28, 2001, note. Therefore, no record trail tied the March 12, 1999, mortgage to the June 12, 2002, note. Since no record notice existed of a mortgage lien securing the June 12, 2002, note, the case trustee, with the status conferred upon him by 11 U.S.C. § 544(a)(3), obtained on the petition date an interest in the Codington County realty that is superior to any mortgage lien interest that the Bank may claim under the June 12, 2002, note and the note's reference to the March 12, 1999, mortgage. S.D.C.L. §§ 43-28-17 and 44-8-10; *Kaler v. Letcher (In re Wegner)*, 210 B.R. 799, 801 (Bankr. D.N.D. 1997) (Chapter 7 trustee could avoid unrecorded mortgage and succeed to mortgagee's interest), *aff'd*, 162 F.3d 1166 (8th Cir. 1998); *The Schleuter Company, Inc. v. Sevigny*, 564 N.W.2d 309, 312-13 (S.D. 1997). Accordingly, there is only one enforceable mortgage on the Codington County realty, and the bankruptcy estate holds any equity in this property above the Bank's

December 28, 2001, mortgage and Debtor's claimed homestead exemption.

Debtor and the Bank's stipulated facts place this equity at \$5,217.98.⁴ This sum is not inconsequential nor is this asset burdensome to the estate. Hence, the Bank has not met its burden of proof to show that abandonment under § 554(b) is appropriate. The case trustee may proceed to liquidate the asset, pay the Bank and Debtor their respective claims, and distribute the balance to creditors. 11 U.S.C. § 363(f) and (h).

Finally, Debtor cannot declare this additional equity exempt. Not only does the record suggest that Debtor may not have occupied the Codington County house as his personal residence on the petition date, the Bankruptcy Code prohibits the exemption. Sections §§ 522(g)(1)(A) and 522(i)(2) provide that a debtor may not declare exempt any property that a case trustee recovers for the estate under § 544 if the debtor voluntarily transferred the property interest. *Kaler v. Overboe*

⁴ The bankruptcy estate retains any equity in the Codington County property remaining after application of the Bank's December 28, 2001, mortgage and Debtor's claimed homestead exemption of \$14,672.50. The actual amount of that equity will not be finally determined until the Trustee sells the property under 11 U.S.C. § 363(f) and (h) and subject to any limitations imposed by a valid lease. See, e.g., 11 U.S.C. § 365(h).

-12-

(*In re Arzt*), 252 B.R. 138 (B.A.P. 8th Cir. 2000). Here, the second mortgage that the Bank claims on the Codington County realty was voluntarily given by Debtor. Thus, Debtor cannot declare exempt the equity that the case trustee recovers for the estate upon the application of § 544.

An order denying the Bank's Motion to Compel Abandonment as it relates to the Codington County realty will be entered. If any purpose would be served thereby, Debtor and the Bank can litigate in state court whether the June 12, 2002, note also constituted or created an enforceable mortgage between the two parties. *See, e.g.,* S.D.C.L. §§ 43-28-14 and 44-8-1 and *Security State Bank v. Cap (In re Van Winkle)*, 54 B.R. 466, 469 (Bankr. D.S.D. 1985) (brief discussion of equitable liens). The state court can also address any homestead exemption waiver issues between the two parties.

Dated this 15th day of August, 2003.

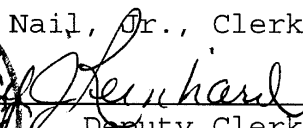
I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

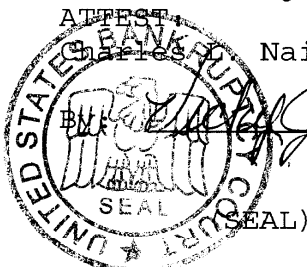
AUG 15 2003

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By _____

BY THE COURT:


Irvin N. Hoyt
Bankruptcy Judge

ATTEST
Charles L. Nail, Jr., Clerk
By 
Deputy Clerk



NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

AUG 15 2003

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

First Premier Bank
PO Box 1348
Sioux Falls, SD 57101-1348

Bruce J. Gering
Office of the U.S. Trustee
230 S Phillips Ave, Suite 502
Sioux Falls, SD 57104-6321

Kermit R. Johnson
1112 2nd Street NW
Watertown, SD 57201

Scott M. Perrenoud
200 E 10th St Ste200
Sioux Falls, SD 57104

William J. Pfeiffer
Trustee
PO Box 1585
Aberdeen, SD 57402-1585

Cheryl Schrempp DuPris
Assistant U.S. Attorney
225 South Pierre Street #337
Pierre, SD 57501

Robert L. Spears
PO Box 1476
Watertown, SD 57201

Terry J. Sutton
PO Box 1053
Watertown, SD 57201-6053